

VISIT...

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- When to enter and exit trades based on Level 2 signals

● **Main Points:**

- In addition to providing insight regarding market maker activity in a stock, Level 2 should be used to help you time your "scalp" trade entries and exits.
- It is worth mentioning again that you should Not use Level 2 alone for your trading decisions, as it can give false impressions of support and resistance; use Level 2 along with Time & Sales, 1-minute charts and general market (or sector) direction to make trade decisions.
- Level 2 is more useful for trading some stocks than it is for other stocks. For example, I find Level 2 not useful at all for trading WCOM, AMZN and INTC, but very useful for stocks like CIEN CMCSK and NOVL. Factors to look at are: how 'transparent' are the lead mm's axes in the level 2 box for the specific stock; the ratio of how many mms vs ECN orders are represented on the Level 2 (eg the higher the ratio of ECN orders to mm orders the less useful L2 is; example: eg DCLK heavily traded on ECNs so L2 not as useful).
- This lesson is designed to help you develop two additional Level 2 daytrading skills: a) knowing how to time your trade entries in Level 2, and b) identifying "high-potential" trading opportunities that can only be seen in a Level 2 screen.

Timing Your Trade Entries/Exits Using Level 2

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Examples:

Situations to avoid buying into:

As we mentioned previously, the "tape is king", not level 2 bands, however we can at least identify danger signs on Level 2 to avoid buying into.

#1) "Wall of Sellers at the Inside" - common sense, if you have many sellers to go through and you're buying long this is a no-no. Conversely, this is a terrific short opportunity (if you can get an uptick).

MMID	Bid	B...	MMID	Ask	A...	
DLJP	21 7/16	10	MASH	21 1/2	107	21 7/16 1.00K
INCA	21 3/8	10	BRUT	21 1/2	53	21 7/16 2.00K
WETH	21 3/8	10	NITE	21 1/2	22	21 7/16 500
ARCA	21 3/8	10	INCA	21 1/2	15	21 7/16 1.00K
MASH	21 3/8	8	MADF	21 1/2	15	21 1/2 200
SHWD	21 3/8	5	WPCO	21 1/2	10	21 7/16 200
ISLD	21 3/8	2	HRZG	21 1/2	10	21 7/16 1.00K
BTRD	21 3/8	1	SBSH	21 1/2	10	21 3/8 100
WPCO	21 5/16	10	GSCO	21 1/2	10	21 7/16 700
REDI	21 1/4	25	PERT	21 1/2	8	21 7/16 700
NITE	21 1/4	22	MWSE	21 1/2	6	21 7/16 1.60K
SBSH	21 1/4	10	PRUS	21 1/2	5	21 1/2 400
BRUT	21 1/4	2	FLTT	21 1/2	3	21 1/2 300
SLKC	21 1/4	1	ISLD	21 1/2	2	21 1/2 200

#2) Indeterminate/low-percentage level 2: If your t&s and charts are not giving you a clear direction and L2 has an approximately equal number of buyers/sellers (or within 10% of being equal), avoid entering a trade.

Again, you only want to enter daytrades on "high-percentage opportunities", not guesses.

M...	Bid	B...	M...	Ask	A...	
INCA	91 7/8	10	ISLD	92	22	91 7/8 200
MWSE	91 7/8	1	ARCA	92	12	92 100
ISLD	91 13/16	6	MASH	92	10	92 100
MASH	91 3/4	2	BRUT	92	6	92 400
NFSC	91 3/4	1	INCA	92 1/16	10	92 900
MADF	91 3/4	1	DKNY	92 1/16	1	92 100
REDI	91 9/16	5	REDI	92 1/8	2	92 100
SELZ	91 9/16	1	MLCO	92 1/4	9	92 100
JRMS	91 1/2	1	MWSE	92 1/4	5	91 15/16 600
COWN	91 1/2	1	SLKC	92 1/4	1	91 15/16 100
SLKC	91 7/16	1	MONT	92 1/4	1	91 15/16 100
MSCO	91 1/8	10	NITE	92 1/2	20	92 100
KTRK	91 1/8	5	MADF	92 1/2	11	91 53/64 200

Keys to Success in Timing Level 2 Trades:

Daytrader Timing Plays: Regular ho-hum trading with Level 2: let's look at the mechanics of using it correctly to time entries and exits

Timing your Entries: Again there's two times you want to buy: on breakouts and on strong bottom bounces. You see those two on your one-minute charts.

Timing entries with level 2 - here's some tips I've found helpful:

1. **The inside bid/ask ratio of market makers and ECNs is important for timing** when you buy or initiate a short. Having one or more of the 4 heavyweight mm's (MSCO MLCO SBSH GSCO) on the inside is a "strong hand" vs. ECNs only. In this example, you see both SBSH and GSCO on the bid with only ECNs (ISLD/INCA) and a weak mm bid (MONT at 1) on the ask. This is very bullish.

(Unless, of course, T&S is telling you differently due to mm's disguising orders via ecn routing; eg if you see 30 orders go through at 27 1/4 and INCA doesn't weaken, then there's a strong seller, another red flag).

Timing your Exits: When should you offer stock out at the ask, or even hit the bid to liquidate? Let's look at some timing indicators. The top L2 NOV window would tell you to sell at 21 7/16 if you could, if you were in from earlier, as it's highly unlikely that all the sellers will liquidate their stock at 21 1/2, so the price may drop 1-3 spreads, shrinking your profit.

Again, use level 2 in moderately/ slow-paced stocks to buy at the offer, sell at the ask whenever possible, so you're not giving up 2 spreads of profit every time you buy and sell. Only pay retail when the stock is moving against you quickly, and the speed is most important. (in which case you might even want to preference an outside-of-the-market mm at a lower bid price so you may be able to exit).

In general, exit when T&S tells you that there's more sellers than buyers. Look for these confirmation signals on Level 2:

1) **The number of market participants** (both mms and ECNs) **starts to shrink** on a) the inside bid and b) the green band (first outside bid

MMID	Bid	B...	MMID	Ask	A...
SBSHc	27 3/16	10	INCAc	27 1/4	10
GSCOc	27 3/16	10	ISLDc	27 1/4	1
PACSc	27 3/16	1	MONTc	27 1/4	1
ISLDc	27 1/8	9	NITEc	27 5/16	1
SWCOc	27 1/8	1	MADFc	27 3/8	10
NITEc	27 1/8	1	PACSc	27 3/8	1
MASHc	27 1/8	1	DAINC	27 3/8	1
WBLRc	27 1/8	1	SELZc	27 3/8	1
SLKc	27 1/8	1	LEHMc	27 3/8	1
FBCOc	27 1/8	1	SLKc	27 3/8	1
BESTc	27	10	SHWDc	27 7/16	10
INCAc	27	4	GKMCc	27 7/16	1
MADFc	27	1	MLCOc	27 1/2	20
GKMCc	27	1	HRZGc	27 1/2	18

2. **Buying when the lead seller is done selling for now.** Let's say some traders are selling via INCA, and INCA now disappears off your inside ask, leaving just ISLD and MONT. This is a good time to buy stock, **but you must be fast**, as the ISLD and MONT sellers will try to pull their offers to sell as well. Here's an example of where a SOES buy to MONT would be a good way to take his stock before he can respond. haha, then the next thing you know the stock is trading 27 5/16 x 27 3/8 (the next major "hurdle" for buyers to overcome), and if SBSH/GSCO and others join the bid, making the yellow inside bid width look good, you've got a winner. Set your stop initially at where you bought in, and trail your stop up, exiting with 1/4 - 5/8 profit.

SBUX						Best Market	P	T	OK
SBUX + 27 5/8						b 27 5/8	a 27 11/16	10 x 44	2.13M 15:38
MMID	Bid	B...	MMID	Ask	A...				
GSCO	27 5/8	10	INCA	27 11/16	44	27 5/8	600		
FBCO	27 5/8	10	ISLD	27 11/16	17	27 5/8	100		
BRUT	27 5/8	6	NITE	27 11/16	1	27 11/16	500		
STRK	27 5/8	5	DBKS	27 3/4	10	27 11/16	1.50R		
NITE	27 9/16	1	SELZ	27 3/4	1	27 5/8	100		
SHWD	27 9/16	1	DEAN	27 3/4	1	27 5/8	800		
FLTT	27 9/16	1	SHWD	27 3/4	1	27 5/8	100		
MADFc	27 9/16	1	MONT	27 3/4	1	27 5/8	200		
INCA	27 1/2	10	SBSH	27 13/16	10	27 5/8	300		
SBSH	27 1/2	5	MLCO	27 13/16	10	27 5/8	100		
MONT	27 1/2	1	LEHM	27 13/16	1	27 11/16	500		
JPMS	27 1/2	1	JPMS	27 13/16	1	27 11/16	100		
CANT	27 7/16	1	MWSE	27 7/8	14	27 5/8	300		
WBLR	27 7/16	1	OLDE	27 7/8	10	27 5/8	300		
DBKS	27 3/8	10	MSCO	27 7/8	10	27 11/16	1.00R		

2) **The quantity of the lead bidders' size starts to shrink:** eg if GSCO's 10 turns into a 6 or a 1 then he's going to disappear; if he's really buying then his 10 would've stayed the same through multiple sellers as seen on t&s, as he refreshes for the tier size.

3) **A "wall of sellers" starts to build,** for example if you see either the number of mm's increase by 2-3 in either the yellow or green ask column, you should get out for now. Remember, you can always buy back in later when it looks safe.

level). Use the green band's # of participants as a leading indicator. Example: if (for the SBUX L2 window) both BRUT and STRK disappear and show up down at 27 1/2.



Always remember: **When in Doubt, Get OUT!** Shakes notwithstanding, you can always re-enter your position at maybe 1/16th or so higher if you were wrong and it was going your way. I frequently find myself getting out a "bit sooner" than the crowd does, before the stock drops 1/4 point or more...it's an instinct that says "nah, they're not buying anymore, it's 'iffy', I'm outta there."

4) **You see the "ax" or other major mm flip from the bid to the ask.** Example: if GSCO jumps over to the yellow ask and 2 more people join him at the bid, you should hit the bid at 27 5/8 and get outta there now.

Identifying High-Potential Daytrades using Level 2

Remember to use Level 2 as a **secondary** decision support tool to help you time exact entries and exits to within 1/16th; it's a "microscope".

Don't use Level 2 alone to decide whether or not to buy or sell stock, but rather **when** (within a 2-minute timeframe) to buy or sell, after making your initial decision using T&S, 1-minute chart and overall market (or sector) strength and direction. Many traders misuse level 2.

Daytrader High-potential Play #1 - The "Rollup":

IF the stock is "breaking out" of a trading range, making a new high, trading actively in one direction, or making a bounce off a hard selloff.

It's usually safe to buy if t&s shows all buyers and you're one of the last ones to buy right before an ask price level disappears off the L2.

How it Works: Lets say this NETA used to have 4 sellers at 24 3/8, and now traders have bought so much that there's only the instinet (INCA) seller left, showing an ask size of one or so. If you're fast, you can "jump on board the last train at the spread" and buy from INCA before the L2 inside goes up a spread (to 24 3/8 bid, 24 7/16 ask). If you time these right, they are usually good for a fast 1-3 spreads profit. (For active traders with daytrading brokers only-type play.)

(As I mentioned before, for moderate or slow-paced stocks you always want to buy at the bid, sell at the ask, this tip is for fast moving stocks).

NETA - 24 1/4 b 2 Last seller on inside ask about to disappear, buy it and watch the price continue up 1-3 spreads.

MMID	Bid	Size	MMID	Ask	Size	Price	Quantity
STRD	24 1/4	10	INCA	24 3/8	1	24 1/4	2,000
LEHM	24 1/4	1	RELI	24 7/16	1	24 3/8	100
MASH	24 1/4	1	MASH	24 7/16	10	24 3/8	800
SLKC	24 3/16	10	VNDM	24 7/16	10	24 7/16	200
MSCO	24 3/16	10	SBSH	24 1/2	10	24 3/8	100
MONT	24 3/16	1	MSCO	24 1/2	10	24 1/4	1,000
NITE	24 1/8	20	REDI	24 1/2	8	24 11/32	100
NFSC	24 1/8	10	BRUT	24 1/2	5	24 3/8	100
GSCO	24 1/8	10	ARCA	24 1/2	3	24 1/4	10,000
SBSH	24 1/8	10	PWJC	24 1/2	1	24 5/16	300
BRUT	24 1/8	5	FLTT	24 1/2	1	24 5/16	900
						24 5/16	300

This usually works when you're buying ahead of a major support level (usually at 1/4 1/2 3/4 and whole numbers) that has a lot of people bidding for the stock.

In the QWST example to the right you see a wall of buyers at 34 1/2. Thus, making a bid at 34 9/16 (or 34 19/32 to frontrun DLJP haha) is probably smart.

Secret to Scalping w/Support in Level 2 Daytrading:

When I scalp, (most of my trades are scalps within a 20-minute roundtrip) I will use Level 2 walls of support **at the first outside bid** (green band) to set my stop.

For example, if I buy at 34 9/16, I would trade this as follows: my stop is at "I'll sell if the wall of buyers at 34 1/2 is almost gone". In other words, if I bought at 34 9/16 and it trades down, the inside now becomes 34 1/2 x 34 9/16 and then the green (now yellow) wall of bidders shrinks down to say 4-5 bidders from it's current 17 then I'll get nervous and probably hit the bid.

This is because the stock didn't do what I thought it would, namely bounce off the 34 1/2 support and climb higher, to a next resistance of 35. Make sense?

So, my downside is maybe 1/8th of a point. My target is 7/8, or about a **3/8 profit**. I'll be smart enough to exit the trade into the buying strength, before it reaches 15/16 and fades back to 3/4.

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Of course, if volume picks up a lot then it may continue on strongly through whole number resistance, but I don't bet on it. Remember, you can always buy back in later. So, I'll buy here, sell up at 7/8, wait for a shake off 35, then buy back in at 35 1/8, if it goes up there. That's how to daytrade, folks.

Ok, time to practice: try papertrading with the above tips; perhaps print this page or summarize the main points and see how it works for the stocks you trade. Remember to keep an eye on the ratio of mm's to ECN's on the inside bid/ask as a key indicator, and that Level 2 is much less useful for stocks that do most of their trading through ECNs.

Level 2 is a secondary indicator to use for scalping and precision timing for entries and exits, not a major decision support tool as to whether you should be buying or selling the stock in the first place.

QWST	Best Market	P	T	OK		
QWST - 34 9/16 b 34 9/16 a 34 5/8 10 x 89 5.62M 14:51						
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